

TECHNOLOGY NEWS

Cash Management: Buyers' Market

Survey Finds Mounting Competition Among Banks

By RICHARD LAYNE

NEW YORK — Banks charged only slightly more for cash management services in 1989 than the previous year, but corporate customers continue to seek contracts based primarily on services rather than on prices, said Phoenix-Hecht, a consulting company.

In its annual survey of 586 corporations that use cash management services, Phoenix-Hecht found that the overall cost of those services rose 5% in 1989. That increase was about in line with general inflation. Bankers predicted a similar, if not smaller, increase in 1990.

The study is published in the 1990 edition of Phoenix-Hecht's "Blue Book of Bank Prices." It found that bankers offer discounts on only 10% of their services, a smaller percentage than many of their peers assumed, the consulting firm said. The average discount price was 27% in 1989, virtually the same as the previous year's 28%. Just as in 1988, banks in the Southeast — where competition is especially fierce — offered the steepest discounts in 1989.

Competition Keeps Prices Down

As corporations reduce the number of cash management banks they use, competition among the 200 major service providers is increasing. Those factors are expected to keep the price down.

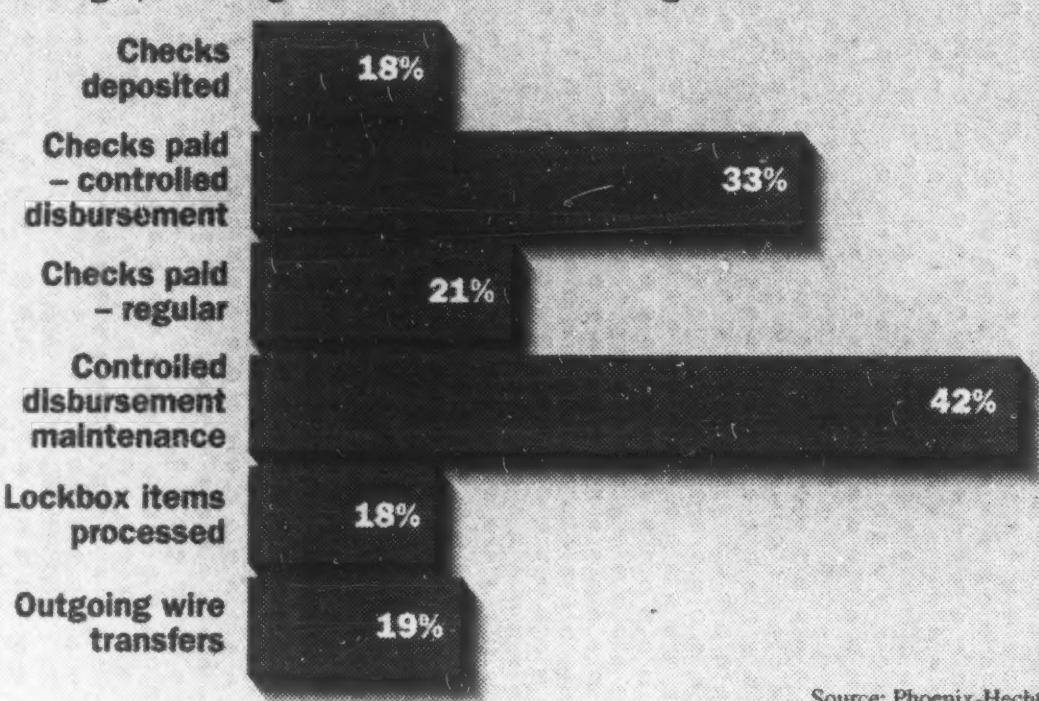
"I think you may see a tendency to follow inflation, but I don't see any big increase coming," said John N. Fix, senior vice president at Continental Bank, Chicago.

"Prices will only go up incrementally because of the competition," said David Kurrash, vice president of Wells Fargo & Co., San Francisco.

Mr. Kurrash said that the

Where the Buys Are

Average percentage discount on cash-management services



Source: Phoenix-Hecht

small rise in price does not endanger banks' profit margins. Additional automation in disbursement and funds transfer can reduce operating costs, which in turn can be passed to the customer.

Service Outranks Price

While corporations exert pressure on banks to cut prices, cost is not a primary consideration in choosing a cash management bank.

"The service issues always rank higher than price any time we do a survey," said George B. Rush, vice president of Phoenix-Hecht in Research Triangle Park, N.C.

Bankers said they are encouraging that nonprice focus. "There is a major effort among banks to focus more attention on quality and value of product delivery than on offering lowest prices possible," Mr. Kurrash said.

Even middle-market corporations, a frequent target of bankers' wholesale marketing efforts,

demand sophisticated service, although perhaps not the same levels of sophistication needed by big corporations with much larger cash positions.

Intense competition among the 20 top service providers has already escalated price wars, said Mr. Rush. Among these cash management elite, bank are forced to compete on price because service levels rarely vary for account reconciliation and controlled disbursement. Corporate customers benefit from discounting of these services, which can be as low as 33% below list. "There's pressure for discounting," Mr. Fix said.

Phoenix-Hecht's study found that the most frequently discounted services are the per-item charges associated with lockbox, disbursements, checks deposited, and automated clearing house debits. Wire transfer services are the least often discounted. Banks are more concerned with security issues surrounding funds transfer than with price, Mr. Rush said. □

CoreStates Expands EDI

By RICHARD LAYNE

NEW YORK — As part of a plan to expand the use of financial electronic data interchange among corporations, CoreStates Financial Corp. will now allow cash management customers to pay for banking services via electronic funds transfer.

Through a banking subsidiary, Philadelphia National Bank, customers can settle invoices by sending a payment and the related invoice number directly to the bank through the automated clearing house network. Banks refer to such transactions as financial electronic data interchange.

Thomas Gregory, assistant vice president at CoreStates, said the bank already performs this service for five cash management customers. Now the service will be standardized on a transaction format approved by the clearing house network.

Mr. Gregory said that he ex-

pects as many as 75 companies to use this financial service, which also provides a chance for the bank to streamline its accounts receivable process. CoreStates is one of perhaps 50 banks that originate and receive financial EDI transactions of any volume. Those banks view financial EDI as a critical aspect of cash management services.

A Last Step

For more than a decade, corporations have used electronic data interchange to transmit invoices, purchase orders, and other trade documents. Financial EDI, which closes the trading loop, is typically the last step for a corporation that already uses EDI.

CoreStates customers that elect the financial EDI program will transmit payment under a widely accepted clearing house format, CCD, which virtually all large corporations use to originate electronic payments. □

Sears Unit in Processing Pact

By KAREN GULLO

NEW YORK — Sears Payment Systems Inc. has begun processing a private-label credit card for the jewelry and home electronics division of Fred Meyer Inc.

As part of its service, Sears is acquiring \$5 million in receivables from the Portland, Ore., retailing company. The Sears unit will provide new-account processing, sales authorizations, statement processing, cardholder services, remittance processing, collections, and credit marketing for Fred Meyer.

Sears Payment Systems, a member of the Dean Witter Financial Services Group of Sears, Roebuck and Co., will also provide electronic authorization and draft capture services for Visa, MasterCard, American Ex-

press, and Discover card transactions.

Seattle-First National Bank had been providing a private-label credit card program for Fred Meyer's jewelry division since 1982. The company decided to switch providers because it wanted more flexibility in application approvals.

The bank, a subsidiary of Sea-First Corp., "was running the program like a Visa or MasterCard program, so there were stringent restrictions on approvals," said Michael Don, vice president in the treasury department. "We wanted to become more aggressive in our private-label program and needed more flexibility."

Mr. Don said the company chose Sears because its fee structure provides for shared liability on credit losses. □

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COMMENT/By Thomas "Lud" Ashley

Bush Signals Broad Changes In Financial Industry Rules

Twice during a recent week the Bush White House sent strong signals of the shifts in financial regulation it will propose later this year. One dealt largely with deposit insurance reform, the other with the need to restructure the financial services industry.

In the budget submitted to Congress two weeks ago by Budget Director Richard G. Darman, the fiscal condition of the depository institution trust funds received top-level attention for the first time in the history of the annual budgetary process. It also provided the first official indication of the approach the Bush administration is likely to take in reshaping the federal deposit insurance system.

Noting that the face value of all deposit insurance programs is more than \$3 trillion, and that future claims are virtually certain to be in the tens of billions of dollars, Mr. Darman said priority must be given to the proper scope of federal insurance, how the costs of these programs should be shared, and how best to manage and control the government's potential liability for losses.

One of the problems, in Mr. Darman's view, is that, contrary to basic principles of insurance, federal deposit insurance premiums do not vary with the known level of insured risk; all institutions pay the same fixed percentage of deposits. The result has been that healthy, prudently managed firms subsidize those that take more risk.

Compounding this problem,

Mr. Ashley is president of the Association of Bank Holding Companies.

says Mr. Darman, large institutions receive greater protection against failure than small ones while paying premiums on a smaller proportion of their liabilities. The too-big-to-fail practice indirectly extends guarantees to deposits over \$100,000 and to other creditors. Large banks allegedly pay lower effective premiums because insured deposits are a small share of their funds.

The effective extension of insurance coverage to deposits over \$100,000 and uninsured creditors arguably decreases the incentive of insured parties to monitor risk-taking, allowing depository institutions to take more risk and increasing the insurance funds' exposure to loss.

Mr. Darman believes a good case can be made for redistributing the potential cost of failures so that the owners and unsecured creditors will be at greater risk. Federal insurance should be priced (through a combination of premiums and capital requirements) in a manner that reflects all sources of risk, prospective as well as current. In addition, the facts about an institution's financial condition should be made clear to depositors, creditors, and stockholders so that the market may impose penalties on poor performance.

Lowering Government Costs

Mr. Darman thinks it may be possible to achieve the goals of deposit insurance at reduced cost by lowering the government's level of exposure to losses. Thus it may be desirable to require some depositors to share some portion of the losses through deductibles or similar features that are standard with

most private insurance.

Taking a page from FDIC Chairman William Seidman, Mr. Darman points out that the government's liability for losses also could be limited by narrowing either the range of investments funded by insured deposits or the types of depositors and creditors protected.

Other reforms endorsed by the budget director include risk-based capital standards, risk-based pricing of insurance, market-value accounting, and

'The administration is convinced that a broad restructuring must include deposit insurance reforms.'

removing regulatory barriers to asset and geographic diversification, product and services integration, and innovation.

The second message from the White House, contained in the "Economic Report of the President," emphasizes the need to consider deposit insurance reform in a broader context that provides a fundamental reassessment of financial policy, that is, "one that is grounded in the sound logic of encouraging efficient, focused competition among financial institutions."

Echoing Mr. Darman, the report points out that the current deposit insurance system has encouraged excessive risk-taking. It suggests that the recent deterioration of credit quality may actually be systemic and not reflect one-time shocks or problems in specific sectors or geographic regions.

Risk-based capital is endorsed by the White House as a "step in the right direction" in maintaining a level regulatory playing field across different countries, a policy goal it sees as becoming

increasingly crucial as cross-border investment in financial services continues. It also shares the Darman views that risk-based insurance would further enhance the incentives to banks with respect to choice of investments and that improvements in the quality of information available to regulators - perhaps through market-value accounting techniques - could lead to better risk measurement.

But Mr. Bush's economic report makes clear that crucial to preserving the fundamental soundness of the financial system is the ability of the system itself to adapt efficiently to competitive challenges from other providers of financial services, both foreign and domestic.

A guiding principle for financial regulation, the White House believes, is that rules should be applied consistently across all types of institutions undertaking the same activities. At the same time, there can be different rules for different activities, with financial institutions permitted to opt for those rules that best fit their competitive strengths.

While they stop short of offering a definitive plan, Mr. Darman's budget documents and Mr. Bush's economic report make it clear that the administration attaches great importance to a broad restructuring of the financial services industry that puts in place policies that enhance rather than constrain the ability of financial institutions to adapt to the constant changes of a competitive marketplace.

It is also clear that the administration is convinced that this broad restructuring must include deposit insurance reforms that protect taxpayers by relying less on regulatory discipline and more on the self-discipline that risk-based capital and insurance premiums impose.

In short, the administration is looking to the most far-reaching overhaul of the financial system since the 1930s, and the suggestion is strong that it will accept nothing less. □

GRAPEVINE/By Jed Horowitz

Bankers Rip RTC Thrifts. William Roelle, the Resolution Trust Corp.'s director of operations, got an earful when he met two weeks ago with a delegation from the Western Independent Bankers, which represents community banks in nine states. The bankers accused RTC-owned thrifts of offering above-market interest rates - the very "Texas premium" the thrift-bailout law was supposed to eliminate.

Sources said Elden Barmore, chief executive of the Rio Salado Bank in Tempe, Ariz., waved advertisements from RTC-owned thrifts that offered 12-month certificate of deposits yielding 8.78% and 8.88%. Mr. Barmore said his bank, which was paying 7.44% on its CDs, lost \$3 million to \$5 million to the government-run competition.

"I will not apologize for above-market rates," Mr. Roelle replied, according to two separate accounts. The RTC has no alternative way of raising funds for some of the sick thrifts it has acquired, he told the bankers.

Mr. Roelle was not available for comment.

— Sam Zuckerman

RTC Rips Competitors. The Resolution Trust Corp. is also taking a harder line with publishers and other conference organizers who offer expensive seminars on coping with, or profiting from, the thrift crisis.

Starting in early April, the agency will launch its own 10-city series of conferences at a bargain price. Rather than the usual \$500 to \$1,000 fees charged by their rivals for two-day conferences - including the *American Banker* - the RTC's one-day meeting will cost \$220 or \$250, according to executive director David C. Cooke. "We want to be able to reach not only the people with deep pockets, but the little guy too," said spokesman Stephen Katsanos. The seminars will feature a general session in the morning and afternoon sessions on thrift acquisitions and asset sales.

There's one more dart for competitors. Seminar sponsors usually pepper their speakers' list with lots of RTC officials. Mr. Cooke says he and his deputies are likely to save their future speech-making for the agency's own conferences.

— Barbara A. Rehm

Group Opens Leasing Shop. Five officials of Bankers Trust Co.'s leveraged leasing unit, including two managing directors, recently left to form their own boutique.

A source outside the bank said Lee Rigney, Anthony Zauner, and three colleagues threatened to leave unless they were allowed to spin off the unit in a buyout.

A Bankers Trust spokesman confirmed the departure of the five employees, but would not elaborate. He also noted that the unit's core managers are still in place.

The unit, which leases big-ticket items such as aircraft, has 25 professionals and is headed by Charles Hill and two other managing directors, Sharon Peterson and C. Wesley Reynolds.

Neither they nor the employees who left were available to comment.

Undermining Marine. Spokesmen at Marine Midland Banks refuse to put a number on the extent of layoffs triggered by the company's radical change in strategy. However, headhunters and some internal sources said they expect 2,000 to 3,000 people to be cut from the company's payroll of 13,800 within the next six months - most of them in Manhattan.

The Buffalo-based company, owned by HongKong and Shanghai Banking Corp., is pulling back on ambitions to be a superregional merchant banking/corporate finance power. "We are certainly looking at moving toward more of a Buffalo orientation," a spokesman in New York said.

A source from the merchant banking area said a team has been formed to spin off various units in whole or in part, including leveraged finance, sales and syndications, and communications and media lending. Those on the team have been offered handsome severance packages, the source said, with bigger payouts if they stay the course until the end.

David Neustadt and Lisabeth Weiner contributed to this column.

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Supreme Court Reaffirms Banks' Securitization Power

Continued from page 1
action.

"It is quite big decision. SIA is always a hard fight," said L. Robert Griffin, director of the litigation division at the Comptroller's office.

Robert Tortoriello, an attorney representing Security Pacific, said the decision backs up the Comptroller's liberal interpretation of what banks are allowed to do.

"It confirms the Office of the Comptroller's view of the way the 'business of banking' can be defined," he said. "It is an important affirmation."

Mr. Tortoriello said that prior to the original case, a number of banks were active in originating mortgage loans, packaging and selling them to the public. Shortly after the decision many banks pulled out of the business and waited for the court to settle the matter. Now, Mr. Tortoriello sees more banks coming back into the market.

Banking Coverage Where It Counts
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The action is a blow to the Securities Industry Association.

The market for securities backed by mortgage and consumer loans is growing rapidly. It stood at \$140.2 billion last year, up 24% from 1988. Those totals consist of securities issued by both commercial and investment banks.

Deluxe to Raise Prices On Printed Products

ST. PAUL — Deluxe Corp., the nation's largest check-printing company, said it will increase prices beginning April 16 to compensate for rising manufacturing costs.

The St. Paul-based company said it will raise prices on virtually all checks, business forms, and other printed items. It said the increases will average 4.75%.

Economic Outlook Brighter, Greenspan Says

Continued from page 1

On other subjects, Mr. Greenspan also told the committee that:

- The commercial banking industry's year-long experience in underwriting corporate debt has produced "nothing negative," a signal that final approval to underwrite corporate stocks is likely to follow soon.

- The pace of activity at the Resolution Trust Corp. should pick up significantly in the coming months. However, he conceded that if it does not, Congress may have to take a second look at the bailout law passed last year.

- The Federal Reserve never considered bailing out Drexel Burnham Lambert Group Inc. The government has bailed out specific institutions too frequently in the past, he said.

Impact on Treasury Market

Mr. Greenspan's bullish remarks on the economy drove down U.S. Treasury securities. The 8½% 30-year bond went into a tailspin and was down two points by midday, at 98-17/32, to yield 8.64% versus 8.47% on Friday.

Given the Fed's apparent concern about inflation prospects, "It's very clear that they will be

willing to tolerate some weak [growth] numbers," said Robert A. Brusca, chief economist for Nikko Securities Co. International.

A number of Fed governors have complained that 4.5% inflation is too high, yet the "central tendency" of expectations within the Federal Reserve System is for price level increases of 4% to 4.5%, Mr. Brusca noted.

"So if you were going to make a bet, the probability is that the likelihood of tightening is much

a slowdown not associated with a recession," she said. "The Fed seems to look upon them as indicating a rebound."

However, Ms. Stephansen said she believes the Fed is taking a "wait-and-see" attitude toward the economy, and is not likely to move without more evidence of the direction of the economy.

"It's typical of the Greenspan Fed," she said. "They react to events," and attempt to engage in fine-tuning of the economy."

Risk Factors Cited

Mr. Greenspan told the House subcommittee that while the Fed is projecting moderate economic growth of 1.75% to 2%, but said there are a number of risks to that forecast.

Chief among them is the increase in leverage, he said, arguing that the structure of the economy's financial balance sheet weighs increasingly heavy on the dynamics of economic expansion," he said.

"In recent years, business debt burdens have been enlarged through corporate restructuring, and as a consequence interest costs as a percent of cash flow has risen markedly," he said.

Banks and other lenders have begun tightening their credit standards, he said, especially for merger and leveraged buyout loans, "as well as for some other business customers."

Debt-servicing burdens have increased for consumers too, and "suppliers of consumer and mortgage credit appear to have tightened lending terms a little," he said.

Mr. Greenspan said it is unlikely that such strains would in themselves precipitate an economic downturn. Debt growth for nonfinancial firms should continue to slow, he said, a trend that should lessen the threat to the economy.

'The likelihood of tightening is much greater than the likelihood of easing.'

Robert A. Brusca
Nikko Securities Co.

greater than the likelihood of easing," he said, adding that it is possible the Fed will push rates up "very soon."

Stable Fed Funds Rate Seen

The central bank is likely to continue holding the federal funds rate at 8¼%, said Stuart G. Hoffman, vice president and senior economist for PNC Financial Corp., Pittsburgh.

"There's no question he is expressing the view that the risk of inflation is greater than the risk of recession," Mr. Hoffman said.

Kathleen Stephansen, vice president and senior economist for Donaldson, Lufkin & Jenrette, said Mr. Greenspan was putting a much more optimistic interpretation on economic indicators than other economists.

"We view them as indicating

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Speed or Haste? Pace at the OTS Causes Concern

By ROBERT M. GARSSON

WASHINGTON — After a rash of thrift closings last week, close observers of the savings and loan industry have begun to ask if the Office of Thrift Supervision is cracking down too hard and too quickly on institutions that might have turned around.

"The OTS can solve its problems most easily by turning shops over to the the Resolution Trust Corp.," said Richard T. Pratt, chairman of Merrill Lynch Mortgage Capital Inc., a subsidiary of Merrill Lynch & Co. "A lot of people are wondering if they are being too tough now," after having been accused

frequently of being too lenient in the past, he added.

Efforts to obtain comment from the OTS Monday were unsuccessful.

The pace of failures has already begun to

strain the RTC's resources, particularly its ability to find qualified managers to oversee conservatorships.

The closing on Friday of Imperial Savings Association of San Diego and Mercury Savings and Loan Association of Huntington Beach, Calif., shows the scope of the problem facing regulators.

One the one hand, Imperial had diversified broadly into new activities allowed during the permissive regulatory environment of the 1980s. But Mercury was a more traditional thrift operating in a favorable economic environment.

Employment Is Right

Mercury was invested in the kinds of housing-related assets that the 1989 bailout law requires all thrifts to emphasize, said Patrick Forte, president of the Association of Thrift Holding Companies.

If the OTS seizes thrifts too quickly, it could increase the cost of the bailout needlessly. The market automatically discounts assets of seized thrifts. As a result, seizing a thrift that would have survived on its own raises the government's cost.

The Bush administration is monitoring the OTS activity closely, and the Resolution Trust Corp. has tried to head off potential "dumping" problems by gently cautioning the OTS that it must be prepared to back up its decisions.

Acceptance Required

The RTC is required to accept institutions that have been declared insolvent and placed in receivership. However, it need

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INSIDE NEWS

SPECIAL REPORT

EASTERN EUROPE: U.S. banks are monitoring developments before committing significant resources. The *American Banker* looks at whether they are missing opportunities for profit or judiciously avoiding the problems of emerging economies. Page 1A

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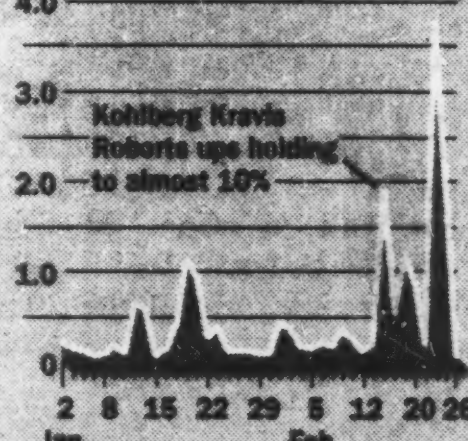
INTERNATIONAL

THE IRS is expected to challenge U.S. banks' use of foreign tax credits to offset domestic income tax liabilities. Page 14

FINANCE

First Interstate's Volatility Soars

Shares traded in millions



Source: DFI Technologies Inc.

INTEREST WANED in First Interstate stock following last week's tremendous trading volume. Page 24

REAL ESTATE

DIVERSIFICATION is one way banks can allay regulators' and analysts' fears about their loans. Page 10

COMMENT

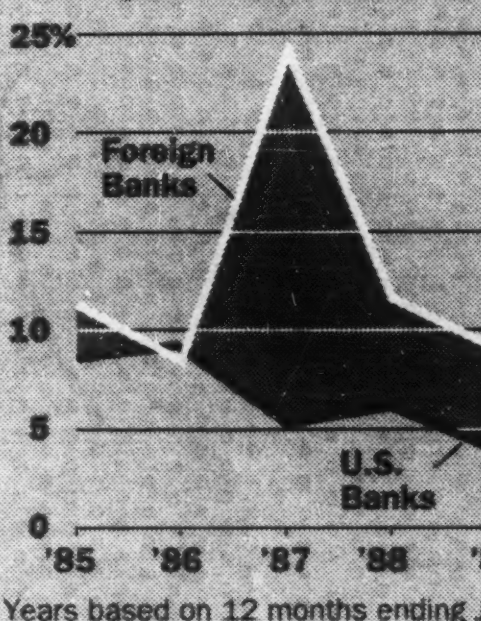
A BOOZ-ALLEN study argues that \$10 billion-asset banks do not operate with maximum efficiency, writes Sanford Rose. Page 4

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Assets Grow Faster at Foreign Banks In U.S....

Annual growth rate of assets

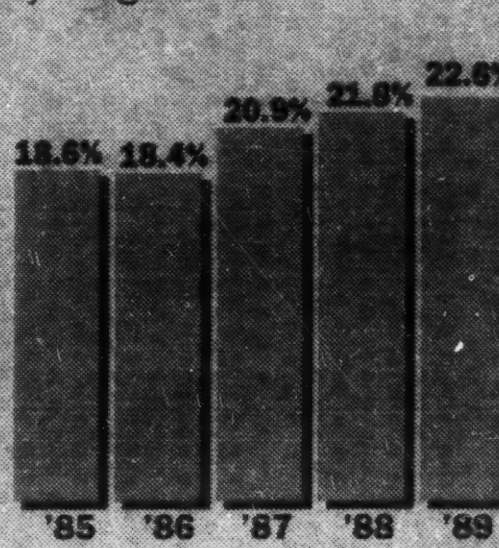


Years based on 12 months ending June 30.

Source: American Banker

...Boosting Their Share Of U.S. Banking Market

Percentage of assets held by foreign banks



Foreign Banks Still Seizing Greater U.S. Market Share

By JAMES R. KRAUS

NEW YORK — Though U.S. banks have decided that bigger is not necessarily better, foreign banks are continuing to increase their asset holdings here at a rapid pace, an *American Banker* survey found.

Foreign banks' U.S. assets surged 9% in the year ended last June 30, more than twice the growth at U.S. banks, according to the annual survey of foreign bank activity in this country.

As a result, foreign banks increased their market share of U.S. banking assets by almost a full percentage point, to 22.6%.

Foreign banks hold an even bigger share of a key component of U.S. banking assets — commercial and industrial loans. An 8.9% growth rate increased those holdings to 28.5% of the U.S. market, up from 27.5% a year earlier. (Tables with the survey results begin on page 17A).

And for the first time, the survey found, the U.S. holdings of a foreign bank — Bank of Tokyo — would rank it among the nation's top 15 bank holding companies.

Moves by foreign banks to boost their assets stand in sharp contrast to the strategy of U.S. banks. Whereas assets once determined the clout and prestige of U.S. banks, today's deregulated and capital-hungry environment puts more emphasis on capital strength, profitability, and productivity.

But the foreign banks — particularly the Japanese — have a different agenda, U.S. banking experts said. Better capitalized foreign banks with profitable home bases have found it easier than U.S. banks to keep adding low-margin assets. Foreign banks also see bigger assets here as the first step toward develop-

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Banks Lose Fight With Credit Unions In Colorado

By ELLEN MEMMELAAR

Bankers in Colorado lost a legislative showdown with credit unions last week in the first of an anticipated series of attempts by bankers across the country to put operating restrictions on credit unions.

The Colorado proposal, known as Bill 1245, would have prohibited credit unions in the state from receiving subsidies from the state and local governments. A committee approved the measure in a vote earlier this month, but the bill was defeated Friday by the House of Representatives in a voice vote.

The Colorado Bankers Association, which helped draft the legislation, regarded it as a first salvo in a campaign to remove what it views as credit unions' competitive advantages.

Nationwide Drive

A banking industry victory in Colorado would have encouraged bank lobbyists in other states as well as the American Bankers Association in their anti-credit-union campaigns. The ABA is spearheading a nationwide drive to eliminate credit unions' tax-exempt status.

Showing the kind of strength that credit unions hope to gather against the ABA effort, hundreds of Colorado credit union members mailed letters to legis-

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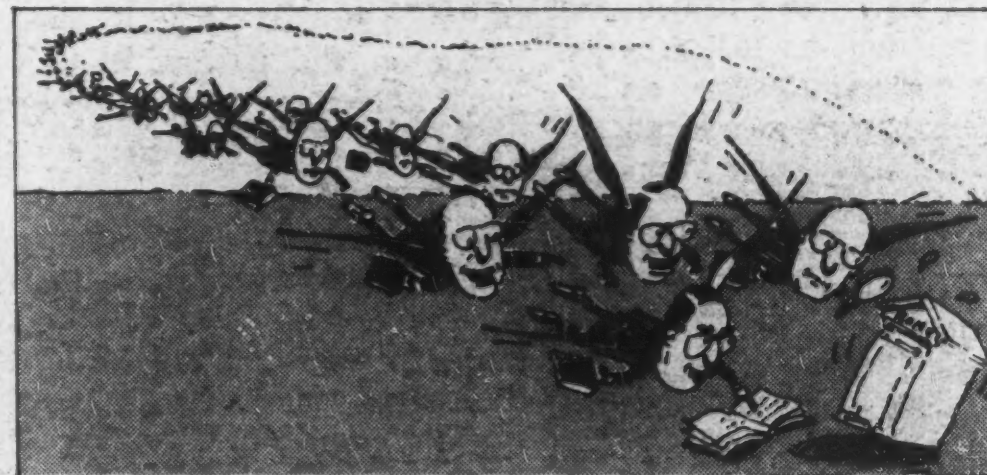
Credit Dries Up as Examiners Go North

By BILL ATKINSON

WASHINGTON — The swarm of federal bank examiners cracking down on lending practices at many of New England's largest banks is rapidly creating a credit crunch in the real estate business that may soon extend to other sectors, say regional bankers, consultants, and developers.

Some banks, yet to be examined, are even second-guessing regulators by tightening credit on real estate projects.

"We have a real liquidity crisis in New England, the likes of which I haven't seen in 20 years," said George J. Fantini, a former banker and now senior vice president of the Boston Financial Group, a consulting firm. "There are projects being rejected today by the banking community that two years ago there



James R. Jones

would have been competition for."

Concerns about regulators in New England have reached the point where bankers and developers have assembled together publicly to air fears that examiners are too tough, and their actions could cause builders to fail.

On Feb. 16, Sen. Christopher J. Dodd, D-Conn., held a meeting in Wethersfield, where more than 30 developers and bankers discussed concerns about pressure from

regulators that has resulted in tightened credit.

"He kept hearing complaints from bankers and developers that the regulators were tightening down in an unrealistic fashion," said Peter Kinzler, an aide to Mr. Dodd.

The tightening of credit has been caused by examiners taking a harder look at real estate portfolios. In some cases, examiners have listed per-

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Real estate brokers who sell RTC properties in competition with other brokers are not required to comply with the ethics guidelines. However, brokers seeking exclusive listing agreements with the RTC must comply with the agency's ethics rules. Experts say the majority of brokers work only on an exclusive basis, which means that a substantial portion of brokers seeking work from the RTC must conform with the ethics rules.

Race for East Europe: Do U.S. Bankers Really Want to Win?

By BRIAN P. SULLIVAN
Special to the American Banker

U.S. banks are falling behind in the race to help rebuild the financial structure of Eastern Europe — a race West European banks are plunging into. West German banks, in particular, are staking out their turf early, seeking rich profits from the emergence of market economies in the former Soviet bloc.

But the Americans — burned badly in their headlong rush to London following deregulation there, reeling from losses on loans to lesser-developed countries, and distracted by big losses in risky leveraged buyout and real estate loans — offer few apologies for their better-safe-than-sorry strategy.

To be sure, U.S. banks are looking around, and several are already operating in Eastern Europe. Citibank has the largest presence, with a joint venture in Hungary. Manufacturers Hanover has had a branch in Romania since 1974. Both banks have been actively placing bond issues for Eastern European countries with international investors.

Chase Manhattan Bank is active in trade finance from its office in Moscow. Though it has no office in Eastern Europe, First Chicago works closely with a Soviet bank to supply financial advisory services to multinational corporations investing in the U.S.S.R.

The possibilities are remote that banks much smaller than these will be heading to Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Yugoslavia any time soon. "If they're not in Paris now, they're not going to Budapest tomorrow," said one international banking consultant.

Huge Growth Market

But the richness of the opportunities in Eastern Europe could turn even the most xenophobic heads in American banking.

Consider:

Average gross national product per capita in Eastern Europe in 1988 was \$5,946, less than half the \$12,515 GNP per capita of the European Community, according to PlanEcon, a leading consulting firm specializing in Eastern Europe. Yet all these countries share essentially the same geography, history, culture, and climate. Even if it takes 20 years for the East to catch up with the West, the potential surge in Eastern European economies could create one of the biggest growth markets in global banking.

The West to the Rescue

The infrastructure needs of Eastern Europe are vast, and only the West has the technical abilities to upgrade them. The opportunity for banks: financing. And U.S. bankers will find a rich mar-

Mr. Sullivan, formerly managing editor of the American Banker, is editor of Eastern European Report, an American Banker-Bond Buyer newsletter on business opportunities in the former Soviet bloc.

ket for their unique technical skills at structuring complex financings.

There will be more help from the U.S. government. In the budget submitted to Congress last month, President Bush asked that the \$938 million appropriated last year for aid to Poland and Hungary also be used for Czechoslovakia, Romania, and East Germany.

The Commerce Department announced this month that it would send an officer to East Berlin to promote U.S. investment. Poland and Hungary already have such officers, and one is likely soon in Czechoslovakia.

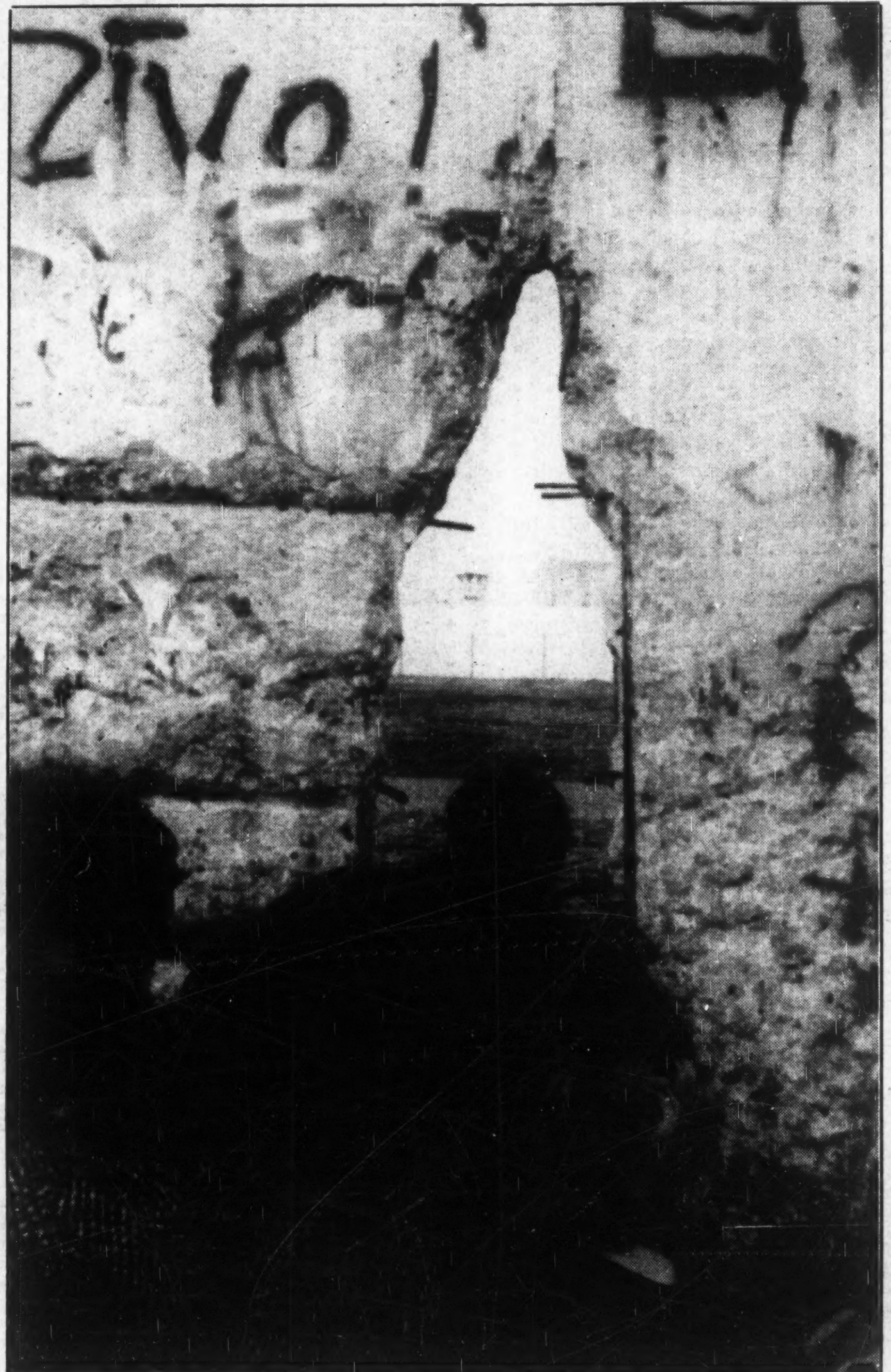
Most-favored-nation status, won by Poland and Hungary in recent years, is expected this year for Czechoslovakia and East Germany. The status grants favorable tariff treatment to trade with the U.S. That means more demand for trade financing.

The Overseas Private Insurance Corp. began offering political risk insurance coverage in Hungary last month, with plans to expand into other parts of Eastern Europe. The insurance reimburses investors for losses due to political turmoil.

"We've got a model now for ones that are coming in the future," said Fred Zeder, president and chief executive officer of the government agency.

More Money Needed

The government monopolies in Eastern European banking markets are coming to an end. Throughout the region, state-owned banks have begun spinning off commercial bank and savings bank operations, and private banks are in the



Brian P. Sullivan

BEYOND THE WALL: With barriers between East and West crumbling, U.S. bankers ponder opportunities and dangers on the other side.

formative stages.

The countries of Eastern Europe will all need increased levels of lending to help spark new business growth. But for many domestic banks in Eastern Europe, loan demand exceeds deposit levels, so Western banks with access to capital will find fertile ground, provided they can find the better deals. Also, businesses in the East will need trade finance. They will need consumer credit.

It was just these opportunities that attracted American banker Michael J. Shade, who moved to Budapest in June 1988 to help set up a new commercial bank in Hungary. Though he sensed a good business opportunity, he didn't expect to be part of history.

"I came because I could see that banking in Eastern Europe was going to

change radically," said Shade, a full-time bank operations consultant to Commercial and Credit Bank Ltd. of Hungary.

"But the rate of change that has gone on in Eastern Europe is way beyond what anyone of us could have expected. It has been unbelievable from a personal standpoint. From a banking standpoint, it has been somewhat frustrating, but we have accomplished a great deal."

Realities of Macroeconomics

There are, of course, numerous roadblocks to overcome. The euphoria of political change has made all things seem possible, but several macroeconomic problems seem inescapable. And any one of these problems could cause an economic collapse, wiping out investments by bankers.

The first major problem is unemployment. Although communism has been a total economic bust, it has managed to give everyone some kind of job. That will no longer be true in market economies, no matter how they are structured.

Euphoria to Unemployment

Discussions with top government officials in Czechoslovakia and East Germany and Hungary in January found many naively claiming that they would learn from the mistakes of other nations, and their neighbors, to avoid high

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EASTERN Europe

The richness of the opportunities in Eastern Europe could turn even the most xenophobic heads in banking.

Continued from page 1A
unemployment. But one of the foundations of market economics is unemployment. The work ethic is not built solely on the hope of advancement; it is also based on fear of losing a job. And wage scales, at least at the lower levels, are kept in check by competition for jobs.

Margaret Thatcher, broadly hailed as a queen of market economics, struggled to end a long pattern of nationalized industry in Great Britain by bringing back a more pure form of capitalism. The result? Painfully high unemployment. It is not likely the new converts to market economics will be able to avoid the same fate.

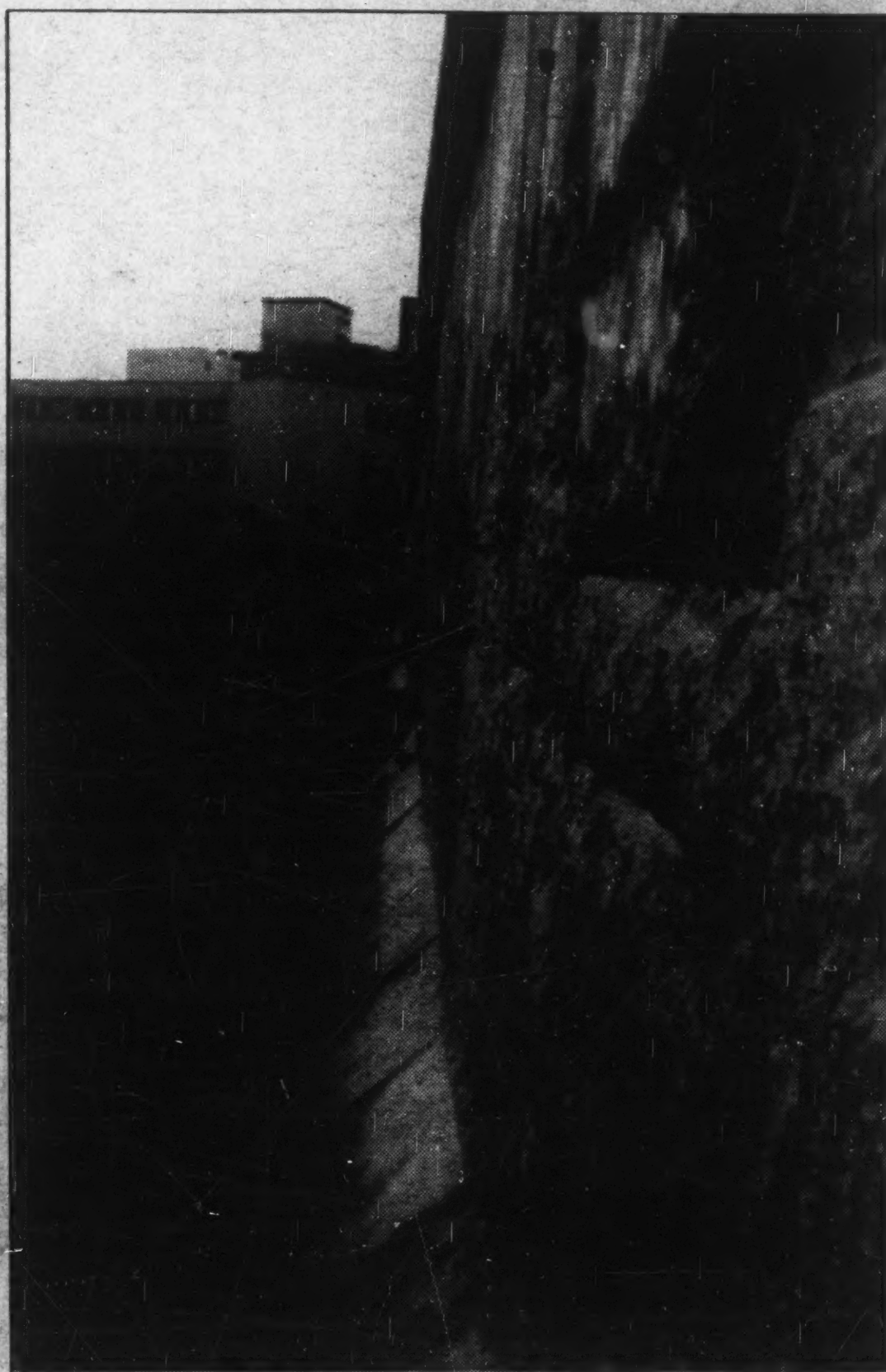
A final worrisome factor on unemployment: with economies in turmoil, it will be difficult—if not impossible—for Eastern Europe to afford the social welfare benefits that make unemployment marginally bearable in the West. Poland recently instituted a carefully crafted unemployment insurance system designed to encourage worker retraining. There was only one catch: There is virtually no money to pay benefits.

The demands for these benefits will be one of the many political pressures that could endanger repayment of sovereign loans. That is, if any U.S. bank has so short a memory that it has forgotten the expensive lessons of LDC debt.

After unemployment, the second big macroeconomic concern is inflation.

Officials in the new provisional governments of Eastern Europe are more realistic about their inability to keep prices under control than they are about unemployment.

Hungary, at the forefront of dismantling price controls, has seen two waves of dramatic price increases. This month alone, rents for state housing rose by an average of 35%, inner-city transport ticket prices jumped 45% (although the cost was next to nothing to begin with), telephone charges rose



Brian P. Sullivan

WILL WESTERN BANKERS scale the obstacles to doing business in Eastern Europe?

35%, and charges for sewage services more than tripled.

The government is forecasting inflation of about 25% this year, but several Hungarian trade and finance officials conceded that it is more likely to run between 30% and 40%.

"The people are very angry" about the price increases, said Gyorgy Gonda, adviser to the chairman of the Hungarian Credit Bank Ltd., and onetime Hungarian commercial counselor in New York. "They don't understand. But if you want a market economy, this is the only way."

High inflation undermines banking by discouraging saving in favor of consumption while increasing loan demand because repayment will be relatively less expensive in the future. In Brazil and Argentina, for example, the populace has become extraordinarily adept at playing the inflation market, making it hard for banks to comfortably manage their affairs.

Good Credit Histories

For all its economic shortcomings, at least most of Eastern Europe paid its bills to the West. The most dramatic evidence of that was in Romania, where the regime of Nicolae Ceausescu forced the country into a murderous austerity program to pay off \$11 billion in debt.

In Hungary, the government keeps pledging to pay off all its \$11.2 billion in commercial bank debt to the West, and true to its word payments are current, although in the future that fidelity is anything but certain.

Indeed, with so much changing, past performance is no longer a guide. Many banks are selling off their share of Poland's \$9.1 billion in commercial bank debt at 16 cents on the dollar, convinced the Poles aren't jok-

ing when they say they have no intention of paying everything back.

The Biggest Gamble

These economic pressures, and others, add up to the biggest gamble of Eastern Europe: that the population will be willing to accept a sharply lower standard

'I think it is fair to say we are cautious' about lending to Eastern Europe.

John Reed
Citicorp

of living in order to help in the tricky business of making over entire national economies. The political pressures may indeed kill the entire venture.

"I think it is fair to say we are cautious" about lending to Eastern Europe, Citicorp chairman John Reed recently told Reuters.

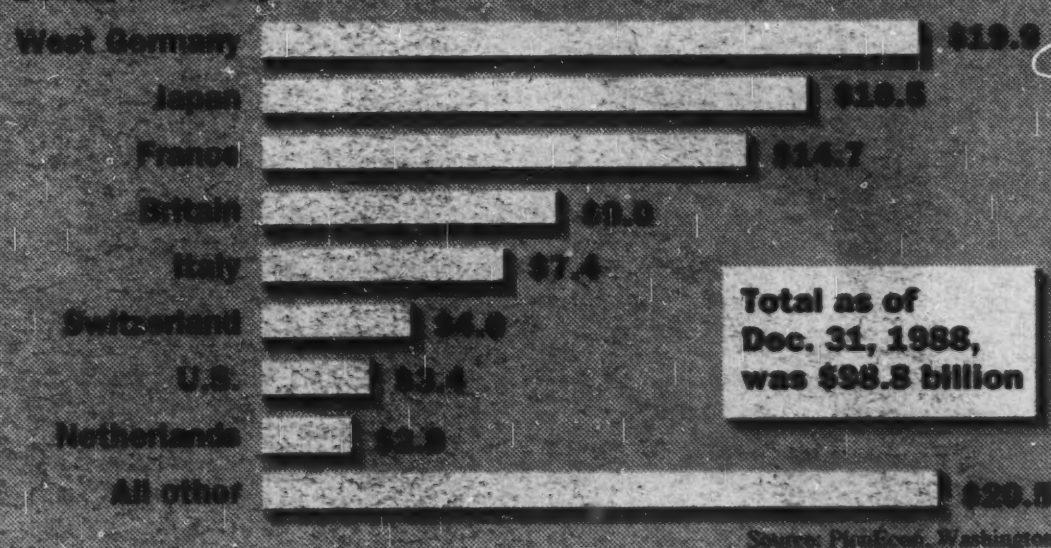
"We are concerned that changes have taken place very quickly... and that it is very difficult for us to forecast where things are going. As we look for opportunities to invest or participate in Central Europe, or indeed Russia... we have to ask if there could not be a reversal," Mr. Reed said.

Eastern Europe's Last Chance

On a gray winter day in Budapest, Mr. Gonda looked from the window of his office at Hungarian Credit Bank toward the government buildings surrounding Szabadsag Square. He commented on the absence of the red stars that once dominated the roof line. They came down overnight, he said, and as shocking a development as that was, it was nothing compared to the difficulty of building a new economy. His immediate concerns were for Hungary, but his words clearly reflected those of his former communist neighbors as well.

"1990 is a turning year in the Hungarian economy," he said. "And it could be our last chance." □

The Big Lenders in East Europe: Western Banks' Exposure in the East



U.S. Investigator Screens Frauds

Money launderers, con men, and hair-brained investors are lining up right alongside thousands of legitimate businessmen, all eager to make deals in Eastern Europe.

Kroll Associates, the New York-based U.S. corporate investigative and security company, is hard at work helping several East European central banks separate the bona fide opportunities from fraudulent ones.

Over the past five months, Kroll has stepped up its investigations by working with consultants in Vienna, relying on their inside knowledge and close relations with Eastern European institutions.

The company is also planning to set up an office in Europe to handle an expected surge in business, but has not yet decided on a location. Kroll's only European office is now in London.

Like many other corporations looking at Eastern Europe, Kroll sees Vienna as a natural point of entry.

"It's a highly developed business center in a neutral country and has always been a center of intelligence for Eastern Europe," said Mr. Pomerance. The Viennese themselves, most of whom are either refugees or descendants of people from Eastern Europe, are probably better attuned to developments there than anyone else.

'Know Thy Customer'

"It's the old saw," said Jerome J. Pomerance, executive managing director. "Know thy customer."

As legislation to prevent money laundering and tax evasion is tightened around the world, observers have predicted, hot money may soon start flowing East to countries like Hungary, which retain stringent bank secrecy laws and are under no treaty obligations to disclose financial information.

But ferreting out the hack business offers, rather than fraud, is the biggest part of Kroll's work in Eastern Europe today, Mr. Pomerance said.

Finding out who you are dealing with on Wall Street can be hard. In Eastern Europe, it is even harder, he said.

— James Kraus

AMERICAN BANKER

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